DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

November 22, 1972 Letter 547

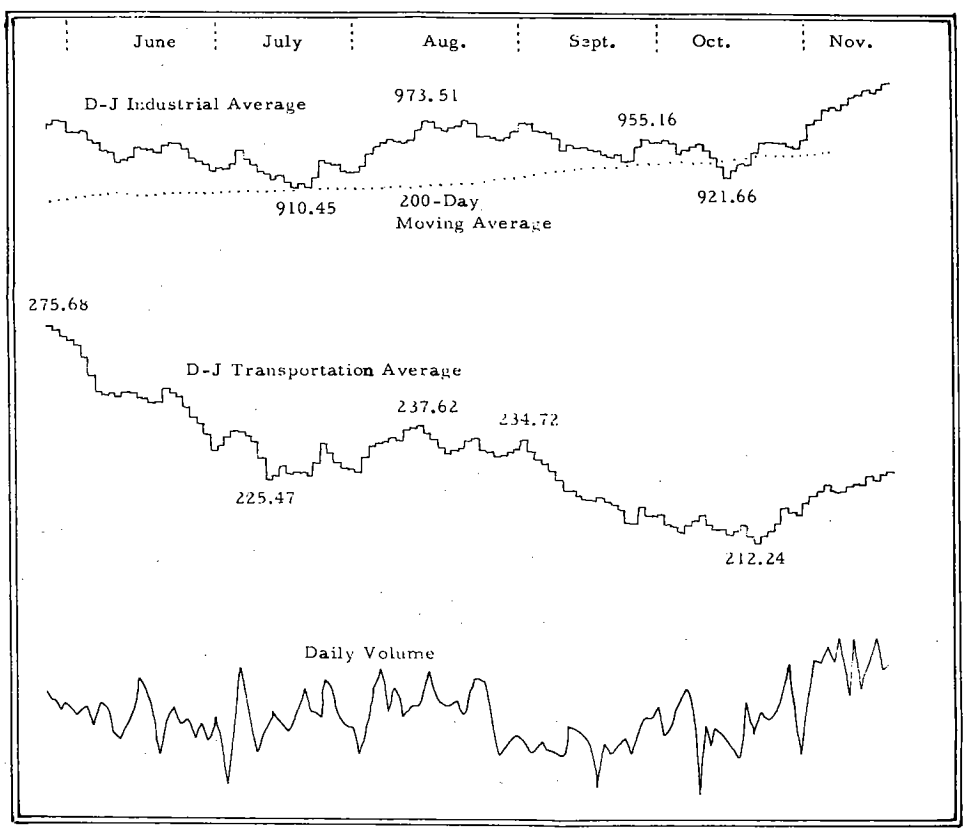
Nov. 10, Dow 995.26, PTI 960, A-D ratio -2.49
Nov. 17, Dow 1005.57, PTI 990, A-D ratio -1.92

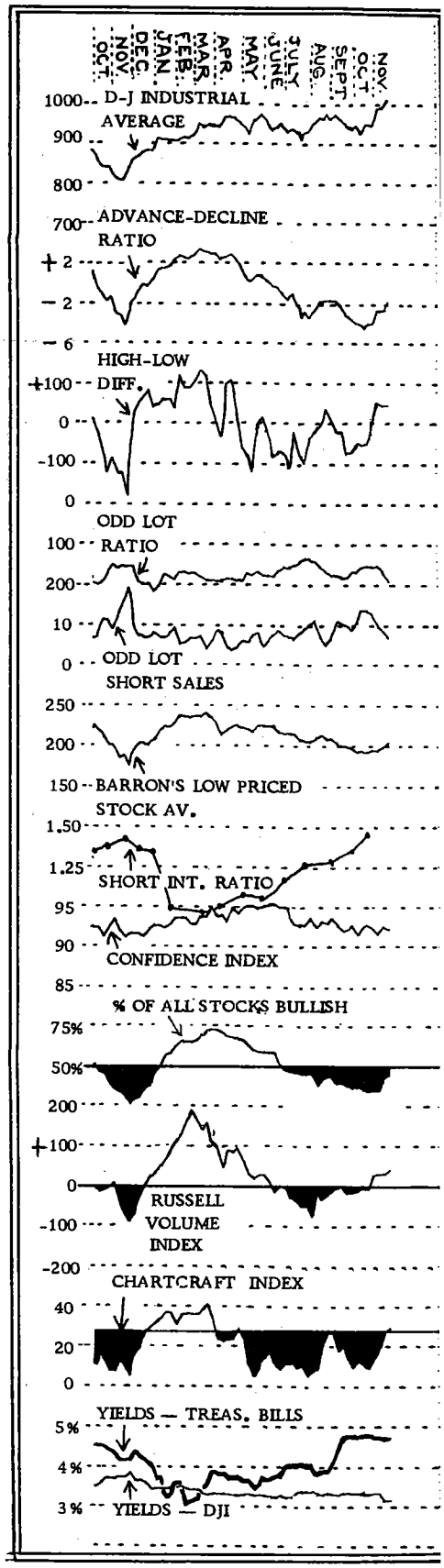
THE MARKET: This juncture is, to my mind, one of the most extraordinary that I have ever seen in the stock market. The Dow Industrials have held in the tightest range in their history (8.6%) during most of 1972 while the majority of stocks have been going down. Just how persistent the majority decline was can be seen on the long-term study of the advance-decline ratio (200-day moving average) in another section of this report.

On Friday, November 10, the Dow Industrials rushed up to close at 995.26, a new all-time high. The historic penetration brought out a mild response, since all eyes were fixed on the elusive 1000 level on the Dow.

Enthusiasm for the new high mark was further muffled by the market statistics which covered the week ending November 10. While the Dow Industrials had rallied 11.14 points for the week closing at 995.26, Transports actually closed lower by .8. Even more surprising, advances outnumbered declines by a mere 206 for the week. Most surprising of all, there was a plurality of only 88 new highs over lows. All in all, a disconcerting lack of strength in a market which witnessed a new all-time high for the Dow.

After mulling all this over and fixing the picture firmly in my mind, I went to bed. At 2 AM that night I suddenly woke up to what seemed like "flashing stock market signals." Here are some of my thoughts that night. "The advance-decline line and most stocks have been weak during most of 1972. Only the D-J Industrials have held up, and even here roughly eight strong stocks in the Average had done the real work. But if the Dow would not go down, then on ultimate cessation of weakness we could



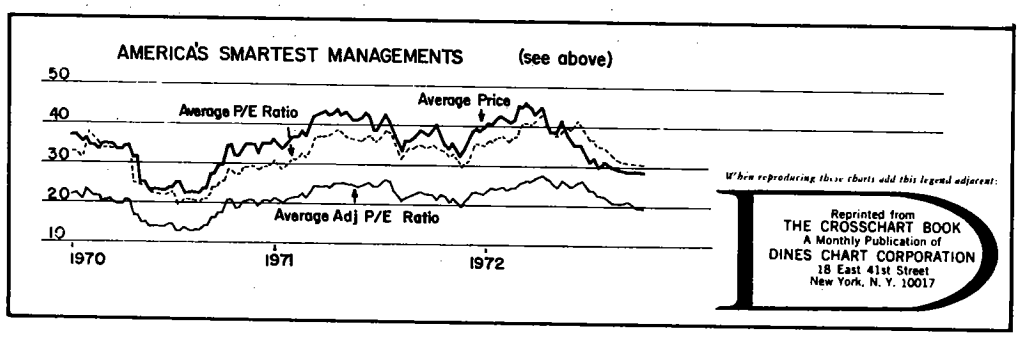


expect it to 'blow off' on the upside. ('The stocks that won't go down in an extended decline are the ones that lead the way up on the next advance') "

Next, we come to the week beginning Monday, November 13. This marked an historic period for Wall Street, for on November 14 the Dow Industrials climbed 6 points to close at 1000.15 — over the 1000 level for the first time in stock market annals. From here on, the market should become particularly fascinating, and the reason is that it is heavily "overbought," the Dow is over 1000, and the advance still does not seem to be "broadening out." For instance, on November 14 (the day the Dow bettered 1000) the 10-day average of daily declines registered 6003 or an average of 600 declines during each of the 10 preceding days! This is alot of selling for a market which produced a new all-time high in the Dow.

This figure (600 declines on average) set me to doing some research, and I came upon an extraordinary fact which helps explain why the public has been so reluctant to enter the 1972 market. During the entire year 1972, there have been only two (2) days, January 5 and September 27, in which the NYSE produced less than 400 declines! Avid market students may wish to check, but I do not believe there has been another year to match this in market history. What these statistics mean is that day in and day out during 1972 a minimum of 400 stocks (or roughly one-quarter or more of the stocks traded daily on the NYSE) have been declining, this while the Dow has been advancing to new highs. All in all, a most incredible performance.

Added consternation has arrived from another quarter. For aside from the "public," which has been sitting sans profits while their portfolios languished amid the sluggish breadth situation, the holders of the glamor stocks and the high flyers have also been receiving their Baptism of fire. James Dines in his Crosschart book (see below) publishes a list and also a stock average of "America's Smartest Management" stocks, which consists of tabulations of outstanding growth equities. I include the chart of that Average, showing the collapse in P/E ratios and prices in this outstanding growth list. During 1972 nothing has held sacred.



It appears to me that the hope of this market has shifted from the high flyer, glamor and growth stocks to the "backbone of the economy" Dow stocks, and this is a switch which is taking most investors by surprise. One reason for the concentration on Dow-type stocks is foreign buying and a return of a portion of the mountain of "deficit dollars" which has built up in foreign coffers. In other words, US debt is coming back "to buy up the backbone of America," and unquestionably Japan (which is up to its ears in dollars) is one of the major buyers.

As a point of interest, I am including this tabulation of Dow stocks, a tabulation which may surprise many. For it shows that the Dow (since 1966) has hardly been the ticket to stock market riches. Only a handful of Dow stocks are now near all-time highs, and incredibly, only two Dow stocks (Eastman Kodak and Proctor and Gamble) went to highs during the period in which the Dow bettered the 1000 level!

So much for what has happened. I feel that the market is now at a most critical intersection, and it would pay us to review the evidence carefully. First, turning to the daily chart of the Averages on page 1, we note that while the Industrials have advanced to historic highs, the Transports have (so far) failed even to better their first preceding peak, the August 23 high of 234.72. A more important level lies just beyond, the 237.62 high of August 11. It will be most important to see whether the Transports can start to confirm by at least pushing

DOW-JONES INDUSTRIALS

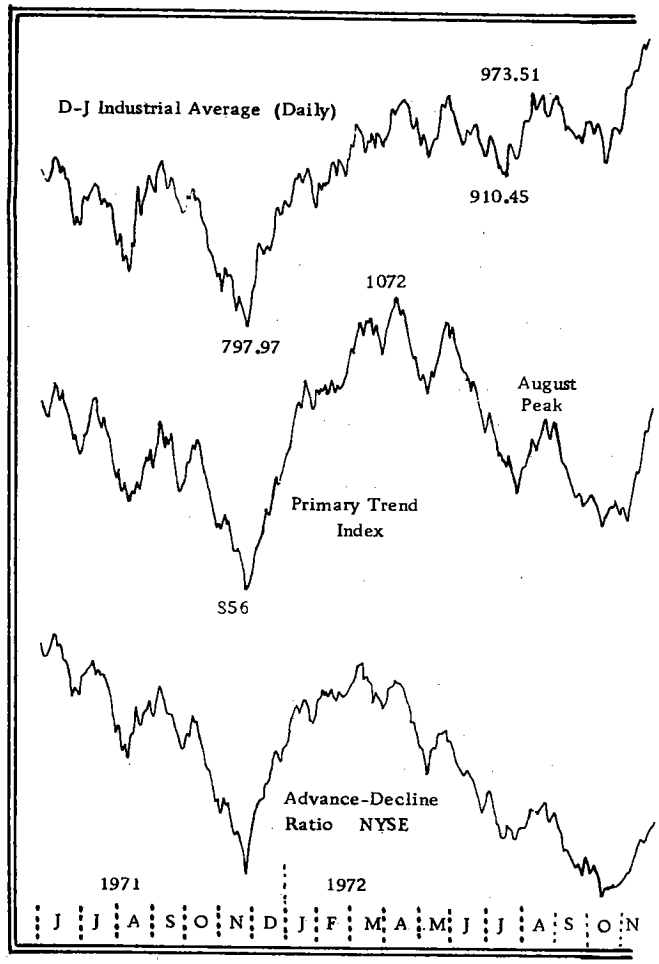
STOCK	RECORD HIGH	YEAR REACHED	CURRENT PRICE
ALLIED CHEMICAL	62-1/2	1961	29-7/8
ALUM. CO. OF AMER.	133-1/2	1956	52
AMERICAN BRANDS	55-3/4	1961	43-1/8
AMERICAN CAN	64	1967	29-3/4
AMER. TEL & TEL.	75	1964	50-1/4
ANACONDA	66-1/4	1968	19-3/8
BETHLEHEM STEEL	59-1/8	1959	28-1/4
CHRYSLER	72-3/4	1968	36-7/8
DU PONT	261	1965	178-1/4
EASTMAN KODAK	142	1972	138
EXXON	92-7/8	1964	87-1/4
GENERAL ELECTRIC	70-7/8	1972	67
GENERAL FOODS	53-7/8	1961	28
GENERAL MOTORS	113-3/4	1965	79-1/4
GOODYEAR	35-1/4	1971	30-1/4
INT'L HARVESTER	52-7/8	1966	37-7/8
INT'L NICKEL	48-1/8	1970	31-3/4
INT'L PAPER	46	1969	39-7/8
JOHNS-MANVILLE	46-1/8	1971	30-3/8
OWENS-ILLINOIS	81	1968	44-1/8
PROCTER & GAMBLE	102	1972	108-5/8
SEARS, ROEBUCK	119-5/8	1972	115-3/4
STANDARD OIL (CAL.)	86	1966	76-3/4
SWIFT	45	1971	35-1/8
TEXACO	46	1964	37-3/4
UNION CARBIDE	75-7/8	1965	47-1/2
UNITED AIRCRAFT	111-1/2	1967	47-3/8
U. S. STEEL	108-7/8	1959	30-1/8
WESTINGHOUSE	54-7/8	1972	42-7/8
WOOLWORTH	55-3/4	1971	35

over the August high. (It is of some consolation, however, that Transports are now moving in the same direction as Industrials or "in gear").

Turning to the chart of the Dow, the Primary Trend Index (PTI) and the A-D ratio (this page), we see that the A-D ratio (while moving up now) has also failed to better the preceding August peak. In fact, since March of this year, the pattern of the A-D ratio failing to better preceding peaks has held consistently. For this reason, a bettering of the August A-D peak would add a big technical plus to this market (and a failure would be just as significant).

However, a great technical plus has just been provided by the PTI. As seen on the chart, on November 18 (last Friday) the PTI hurdled its own August peak, and consequently, for the first time since March we have a rally in which the PTI (which I consider a most important indicator) has surpassed a preceding high. It should be remembered that the PTI is an amalgam of eight leading technical indices. When the PTI is strong and bettering previous peaks, it indicates that the broad technical fiber of the market is "upside and in gear," and the PTI is the first index I have which says that the market is "pulling itself together in the upward direction." This is the first time this has occurred since March, 1972.

For the week ending November 18 we had a plurality of 526 advances over declines, a respectable number. The plurality of weekly highs over lows was 108, hardly something to write home about but nevertheless the highest since April 14. Volume for the week was 100 million, indicating huge energy required under the "market boiler" to make progress from this point on.



Conclusion: I do not want to discount the upward penetration of the PTI. This critical indicator is saying that there is an increasing amount of technical strength in this market. If true, confirmation should be forthcoming shortly from the A-D and the Transports.

Over the broad spectrum of the past three years, the market as measured by the A-D ratio or an unweighted average such as Value Line is not far from its lows. I have been following many investment services who have been bullish throughout 1972. They have listed many "buys" and most of those stocks are now down and ironically, with the Dow over 1000 the buyers are showing losses. With the PTI over its August peak, the case for a "blow off" or a "running of the shorts" becomes at least reasonable. There are only two ways I would speculate for the upside from here: (1) With purchases of shares in no-load mutual funds. (2) Diversified purchases of the strongest Dow stocks as shown at the back of this report.

Caution...I "feel" that this market wants to draw the public in — and in the worst way. Don't forget, the odd-lot and mutual fund public have been exiting for many months now, and the "carrot" of a Dow over 1000 will be the lure which (it is hoped) will bring the public back. If the public comes back, the market may yet broaden out and blow off. I suspect that this is going to continue to be a very difficult market to make money in. Individual stock selection (except in the Dow stocks where we have a good deal of technical data) will be extremely hard. No-load funds, on the other hand, should tend to move with the market.

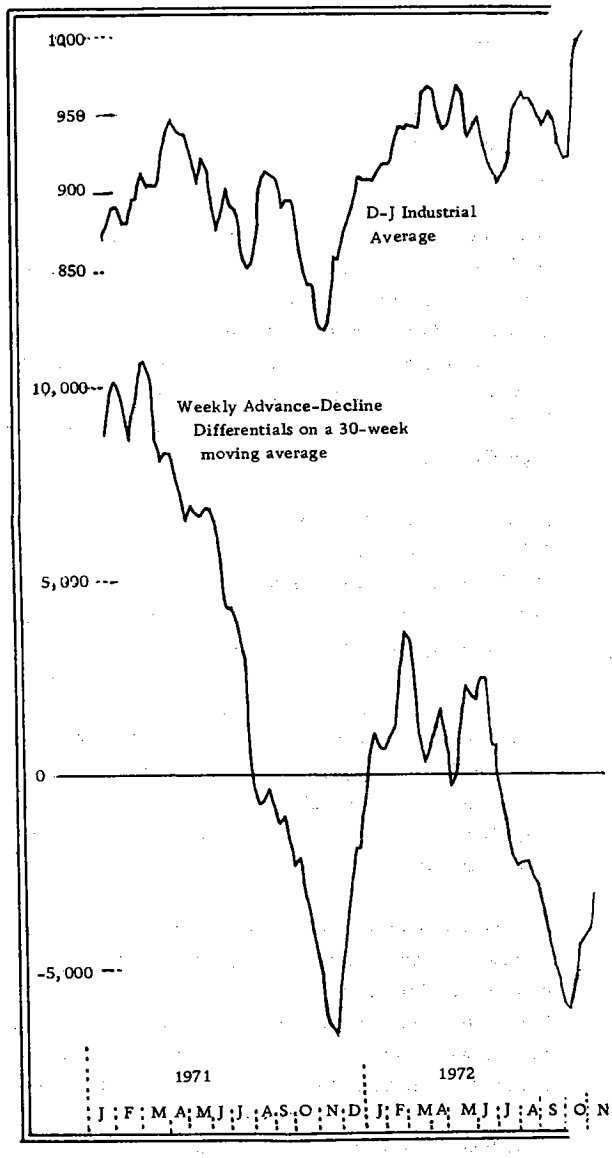
LONG-TERM BREADTH: The chart on page 4 has appeared periodically in these reports. It is constructed as follows: Each week the plurality of advances over declines are tabulated (vice versa if there were more declines than advances). Figures are taken from Barron's weekly statistics. Then these pluralities are arranged in the form of a 30-week moving average, and the results are shown on the chart.

What we see here is the long-term level and trend of the weekly advance-decline ratio. This index provides an interesting commentary on the direction and level of the majority of stocks on the NYSE. Note on the chart that the peak of strength on this index

arrived in March, 1971. A long, costly collapse in the index followed, ending in November, 1971. A new advance carried the index roughly halfway back to the 1971 high. But the new rally was short-lived, ending four months later, in March, 1972.

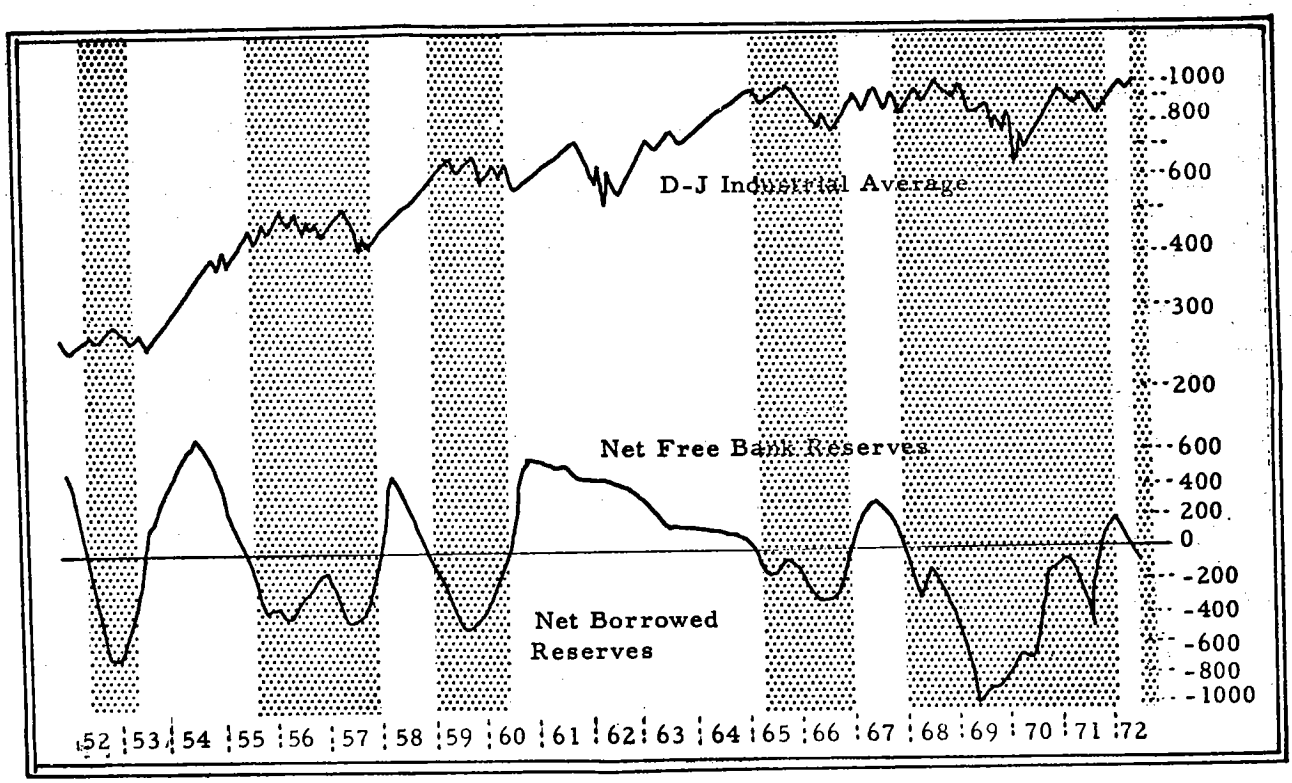
From the March peak, a large descending zig-zag pattern was formed. In July the pattern broke down, and once again the index headed steeply lower. By the first week in October, the index hit a minus 6,000, less than 1,000 above the November, 1971, low. The index has been moving up over the past few weeks, and, of course, no one knows how high it will rise.

Two factors are significant on this chart, the level of the index and the trend. The level is currently far below zero, indicating that the A-D ratio is in bearish territory, with a heavy preponderance of minus pluralities over the past 30 weeks. The trend of the index is now considered up, but the surprising factor is the sluggishness of the rise in this index since the recent lows. Again, the inference is that while the Dow Industrials have been creating fireworks on the upside, the vast majority of stocks have been anything but enthusiastic about heading higher (and this is even more the case on the AMEX and NASDAQ).



NET RESERVES: The accompanying chart (below) was redrawn from one which appeared in the current issue of the Cleveland Trust Business Bulletin. The chart shows the effect of monetary policy of stock prices over the past two decades.

The shaded areas on the chart indicate periods in which the banks have to borrow money from the Federal Reserve in order to meet reserve requirements. What the chart shows is that during these periods of more stringent monetary policy, stocks usually move sideways, decline or at best become highly selective. Sometimes, as in the 1956-1957 period, a long sideways movement occurs in the Dow with the market becoming more and more selective (and the advance-decline ratio moving towards topping out). Then in



a final move the Dow itself declines as was the case during the severe correction of 1957. This same effect occurred during 1959-60 and in 1965-66.

The period of 1968-71 was the longest period of net borrowed reserves of the Post World War II period. Note that reserves were "positive" for a brief period during 1972, but as the inflation forces became embarrassingly obvious, the Fed again moved the banks to a net borrowed position, and this is the monetary stance at present.

I feel that this current borrowed reserve position will make for a viciously selective market from here on (as it has been all during 1972) regardless of where the Dow goes. For this reason, I believe the special studies of the strongest and weakest Dow stocks (the new feature of Dow Theory Letters) will be of utmost importance.

INCREDIBLE FACTS: According to statistics released by Gideons International, 10% of all the Gideon Bibles placed in hotel and motel rooms are stolen each year.

In the book, "The Humane Society," by Wilhelm Ropke (one of the great conservative economists) the author states, "The utmost limit of the welfare state, then, lies at that point where its pumping engine begins to deceive everybody. Some nations have already reached that point."

In view of Ropke's statement, the following facts, I felt, were rather fascinating. If the $75 billion per year that Federal and local governments spend annually on welfare were simply divided up among the 25 million people in the poverty class, each person would receive $3,000 a year and a family of four would receive $12,000. That is higher than the average family income in the US! In other words, the nation would be better off if all welfare administration was done away with and checks were simply mailed via computer to the poor.

Last year the US spent $80 billion on armaments. The high cost of technological warfare means that it now costs the US $200,000 to kill a single enemy soldier!

The 93 underdeveloped nations now spend 40% more for war and armaments than they do for education.

Government spending during President Jefferson's years in office ran $8 million per year. The US Government now spends that amount every 15 seconds.

Of the 56 wars since 1945, all but two have been fought on the soil of poor nations (such as Korea, Sudan, Bangladesh, Biafra). During the last 200 years, only the US has been literally untouched by the destruction of war on its own soil.

STOCKS: I am particularly excited at this time about the special technical studies of Dow stocks which have been appearing in each report since Letter 544. For it seems to me that this intricate breakdown and analysis of the technical position of the individual Dow stocks could not have come at a better time. Over the months ahead it should prove to be an increasingly valuable tool in dealing with this most difficult and selective market. In fact, in reviewing the "strong Dow stocks" which have been mentioned in these studies, I was pleased to note that almost all of them have been spearpointing the Dow attack on 1000, such stocks as United Aircraft, Standard of California, Telephone, Standard of Jersey, Proctor and Gamble. I am currently in the process of subjecting some of the Transport issues to the same analysis, and here again results should be most interesting.

With this mailing I am adding one new indicator to our list of technical data on the 30 Dow Industrials. This is the Momentum line, which is simply the ratio of each stock against its price of 13 weeks ago (Thursday closes are used). Thus if a stock is exactly where it was 13 weeks ago, the MO will be at 100.

If the stock is rising on a trend basis from its price of 13 weeks ago, the MO will advance along a rising trendline. One of the important features of the MO is that it shows when a rate of advance or decline is slowing down, halting and then reversing. The best time to buy a stock would usually be when it is reversing from a long MO decline.

Remember, MO has only to do with the stock itself and does not have to do with the group or the market. If a stock's MO is rising in a rising market, all it means is that the stock is advancing on a 13-week basis but in order to see whether the stock is outperforming the market, one has to look at the relative strength (RS) line. If MO and RS are rising in a rising market, it means that the stock is not only climbing against its price 13 weeks ago but the stock is rising faster than the general market. The converse is true with declining MO and RS in a declining market.

Turning to Anaconda, this stock was reviewed in the last issue. It has done nothing since then but it is rated 4 since everything is plus but RS. Anaconda has been a very depressed issue and has cost holders a fortune over the past few years. Now, as the stock moves above its 10-week moving average, the odd-lotters are stepping up their selling. OBV is good and MO has been rising. Anaconda would seem to be one of the potential low-priced winners in the Dow.

The two auto stocks in the Dow have turned strong on the technical charts and both have a 4 rating out of a possible 6. Chrysler is strong on almost all counts, and the fact that it has a short interest is a plus, even though that short interest is in a slight downtrend. If the short interest moves up on the next reading, Chrysler will have a 5 rating. Odd-lot activity in Chrysler has leveled off, and the stock would gain the ultimate in technical strength if the odd-line would start rising. Even so, this is one of the really strong issues in the Dow at this time.

The exact same can be said of GM, but since this is a bigger issue (more shares) and higher priced, it cannot be expected to show the same rate of appreciation. This can be seen on the two MO indices with MO in Chrysler obviously stronger. Note in both Chrysler and GM, the odd-lot ratios, although not climbing, are above 100. This means that the public is selling the shares on balance (although not at an increasing rate, which would be far more bullish).

GOLD: Sorry, no room for the gold chart this week. Gold has been "testing" the $60 level under the pressure of limited Soviet gold sales. So far, $50 has held. I believe that Mr. Nixon has plans to promote gold and oust Mr. Volcker, our rabidly anti-gold Under-Sec. of the Treasury. More on this next issue.

TECHNICAL CHARTS on the Dow stocks are constructed as follows: Weekly high, low and closing price for each stock is plotted.

(1) Price fluctuates above or below a 10-week moving average (MA) of price. The MA is advanced three weeks in front of price. This is done because the process has been tested and provides the best buy and sell signals.
(2) On-Balance-volume (OBV) is cumulated volume. If a stock rises on a given day, all the volume for that day is considered plus, and is added to the previous day's total. The converse is applied if the stock declines. The Wednesday figure is plotted each week on the chart.
(3) If a short interest exists in the stock, it is shown on the chart.
(4) Relative strength (RS) is a ratio and indicates the stock's action compared with the "market." The market, in this case, is the S & P 500.
(5) The Momentum index (MO) used here is the ratio of the stock's price to its own price 13 weeks ago. Thus, while relative strength (RS) gauges the current performance of the stock against the general market, MO measures the performance of a stock against its own previous level. Important: If the market is declining, rising RS in a stock does not mean that stock is rising, it simply means that the stock is declining less rapidly than the market. But rising MO always means that the stock is actually rising, regardless of the market. Rising RS and MO indicates that not only is the stock outperforming the market, but the stock is trending above its own price of 13 weeks ago. RS tells you what to buy; MO tells you when to buy.
(6) The odd-lot ratio is the ratio of odd-lot buying to selling in the individual stock. These weekly ratios are plotted on the chart in the form of 4-week moving averages. When the odd-lot ratio rises it indicates a move towards selling, a declining line indicates less selling or buying. A ratio of 500 means 500 shares sold for each 100 bought; a ratio of 50 means 50 shares sold for each 100 bought.

Each of the six indicators is worth a point. Stocks are rated from zero (least strength) to 6 (most strength).